PHILIP MORRIS U.S.A. INTER-OFFICE CORRESPONDENCE
120 PARK AVENUE, NEW YORK, N.Y. 10017

TO: David Dangoor DATE: April 24, 1991

FROM: Michael Mahan/Arthur Goldfarb

SUBJECT: Scenarios/Responses to Recent Sub-generic Expansions

As you requested, this document contains three scenarios/options for Philip Morris USA to employ in response to recent competitive sub-generic entries. Specifically, the three following discussions with a Philip Morris response are described.

1. A modest increase in Bristol distribution and support commensurate with other i.e. current, participants in the sub-generic category. Our underlying premise in this scenario is that the RJR plan on behalf of Magna and/or Sterling essentially positions, rather than aggressively promotes, these two new entries.

2. An aggressive Bristol expansion plan involving considerably higher levels of support. Essentially, our current defensive strategy in existing in the sub-generic category will become offensive, positioning Bristol above and beyond Montclair, Raleigh Extra, Misty and Bull Durham to meet the threat posed by Magna and/or Sterling in a more focused competitive environment. Our underlying premise in this scenario assumes an aggressive Magna and/or Sterling introduction in which these brands take a merchandising and distribution profile characteristic of Doral i.e. full distribution and promoted volume of 65 - 75%.

3. The third scenario addresses the Alpine/Belair situation and should not be considered as an option to be pursued in lieu of either of the above actions on behalf of Bristol. It does, nonetheless, have an impact on our overall strategy from a P/V portfolio standpoint and therefore is described in the context of a rapidly changing sub-generic environment:

We believe, David, that for the purposes of your meeting today, these three scenarios should be discussed against the backdrop of several marketplace dynamics that have a bearing on the action/reaction response/counter response the industry is likely to engage in in 1991. As such, we have included a briefing paper in this document in addition to the scenarios you have requested.

David, additional details as to specific launch plans are being worked on. By next week you will be provided with a more concrete plan including financial and unit implications.

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Discussion 1

Assumed Scenario: RJR's strategy on behalf of Magna and Sterling is to position both Brands in the sub-generic tier without aggressively pursuing expanded distribution or promotion. Inherently in such a strategy is an objective to improve both brand's performance and net profitability by simply enjoying the growth of the category and investing modest promotional resources.

Positioning relative to the subgeneric category

Assuming no decrease in distribution, among 6 subgeneric brands Magna and Sterling would rank 1 & 2 in distribution respectively:

Magna	64%
Sterling	48%
Raleigh Extra	43%
Montclair	39%
Bristol	30%
Pyramid	29%

From a portfolio standpoint RJR would be well positioned in key trade classes

Convenience Store

	Dist.	Rank	Share	Rank
Magna	68	1	.76	3
Sterling	27	6	.13	6

Supermarkets

	Dist.	Rank	Share	Rank
Sterling	81	1	.35	5
Magna	68	1	.28	6

Significance: Despite Magna's lackluster performance, the level of distribution in C-stores provides a tremendous advantage. The lack of labor and/or extensive store disruption to effect a price change and call out in the C-store environment (header card change, B1G1F's and POS) coupled with existing distribution could easily result in significant growth (.15 share point per month).

In the remaining trade classes RJR could pursue display programs on behalf of both brands similar to our own efforts on Combined Cambridge/Alpine programs (PV). At minimum, subgeneric sections in carton outlets consisting of Magna and Sterling with dominance of position and signage should be expected. The combined share of these brands are as follows:

Supermarkets	.63
Grocery	.68

The distribution advantage in chain supermarkets is enormous. Although supermarket distribution of subgenerics is 78%, weighted distribution is only 39%. In other words, supermarkets tend to carry a few subgeneric packings in no particular defined or segregated department. Consequently, RJR's ability to

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PHILIP MORRIS U.S.A. INTEROFFICE CORRESPONDENCE

120 PARK AVENUE, NEW YORK, NY 10017

TO: D. Dangoor DATE: April 24, 1991

FROM: M. Mahan/A. Goldfarb

SUBJECT: COMPETITIVE RESPONSE...EXECUTIVE SUMMARY

David, the attached document provides you with details of RJR's activities and our proposed distribution expansion alternatives to ensure PM's competitiveness in the sub-generic segment. Briefly stated, we believe that Bristol expansion should be primarily targeted against pack outlets, while Cambridge, in conjunction with Bristol (where appropriate), should provide us with the basis for our carton outlet response.

Additionally, a reduction in Alpine's list price should be implemented at the national level **immediately** in order to place further pressure on RJR. Below are a number of critical issues that need to be highlighted in relation to our overall decisions.

ISSUES

° Bristol merchandising in c-store/grocery outlets.

- most efficient approach is to utilize existing BV's.
- opportunity costs to Cambridge versus Bristol gains may not warrant this strategy --- Cambridge SOM in convenience stores: 2.65; grocery stores: 2.94.
- alternate approach would be to pay an extreme premium for a separate/ second footprint.

° PM merchandising capabilities in mainstream carton outlets.

- Unfortunately, PM still lacks the merchandising row depth, in traditional carton outlets, to sustain both Cambridge and Bristol franchises.

	Total PM P/V Rows in Self-Service Outlets
Chain Supermarkets	17
Independent Supermarkets	25
Mass Merchandisers	15
Total Universe	16

- In order to play out the competitive strategy in these environments, we need to take the handcuffs off of Cambridge and let it compete versus the lowest price point in-store. Currently, Cambridge is performing at the 3.34 level, in Supermarkets, +0.52 vs. YAG.

- Unless RJR establishes a separate merchandising section for sub-generics our ability to buy rows or place free-standing footprints for Bristol will be a long term process. The primary short term alternative will be to cannibalize existing Cambridge rows. The need to place Bristol in full distribution (supermarkets/mass merchandisers) may not be practical in all situations.

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° Bucks as alternative response to sub-generics in c-stores.

- Bucks already has depth of distribution in c-store segment.

	W/E Dist	Dist of Any Packing
Bucks	73	81
Magna	68	85

- However, this strategy may play into RJR's hand as they may be seeking maximum disruption to Marlboro, and welcome a repositioning of Bucks given the long term implications.

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departmentalize and exclusively enjoy graphic support could legitimize the segment in supermarkets and establish category leadership in a short period of time.

In summary, Scenario 1 represents the least aggressive RJR approach in which RJR leverages high C-store distribution with modest pack support. In the carton outlet environment, RJR's merchandising strength allows them to departmentalize under RJR sponsorship achieving defacto control of the category. RJR assumes profitability will be achieved through naturally occurring growth and future pricing action.

PM Response

Although the scenario described above represents what we believe to be the least aggressive strategy that RJR is likely to employ, it does require a significant change in Bristol's distribution and merchandising profile. Specifically, Bristol's level of distribution in C-stores should be increased immediately. We could in a matter of days institute a distribution drive featuring introductory/gratis allowances and generous B1G1F allocations. Specific geographies where distribution shortfalls exist could be targeted, specifically:

Geography/Section	Distribution	Highest Comp. Distribution
12	14%	37%
15	5%	20%
21	16%	40%
24	19%	44%
25	39%	74%
26	8%	32%
41	12%	50%
43	38%	58%
45	28%	56%
46	31%	63%
51	9%	58%
52	2%	35%
53	0	24%

We would send out an incremental month's worth of Price Reduction @ 1.00 to support our distribution drive. In conjunction with an expanded distribution drive we could modify the BV schedule to require Bristol's occupation of the unit thereby ensuring distribution in 117,000 pack outlets. However, the impact on Cambridge/Bucks must be seriously considered.

We believe the continuation of expanding Bristol distribution in key geographies and an enforced distribution and display positioning in pack outlets will result in Bristol achieving parity distribution or better with Montclair and Raleigh Extra (60-70% range) at minimal cost. Specifically, costs are as follows:

Gratis	$.50 - .75mm
B1G1F's	$2.50mm
Carton Price Reduction	$1.00mm
Total	$4mm
Funded	$2mm

We will analyze unit projections to determine the need for incremental funds in 2RF. You should assume a significant portion of the costs outlined alone could be funded in our existing budget.

Discussion 2

Assumed Scenario: An aggressive Bristol launch targeting full distribution (90% plus) with aggressive price reduction (60% volume). Our underlying premise in such a scenario assumes that RJR's strategy is to aggressively promote Magna and Sterling at a level commensurate with Doral. Quite frankly, such a scenario only differs from Discussion 1 in the level of promotion. From a distribution standpoint the combined distribution of Magna (pack outlet focused) and Sterling.(carton outlet focused) match or exceed Doral's 83% weighted effective distribution. Furthermore, subgeneric distribution (any packing in distribution) is 78%. Therefore, full distribution of Magna and Sterling combined is a certainty. A response to such an approach requires a full scale "down the street" launch with FSF support. Key issues to be addressed are:

1. An aggressive sell-in offer consisting of 20% gratis at minimum.

2. Prioritization of Sales Rep call mission making the placement of Bristol display and POS a first priority. In other words, Bristol must be the primary occupier of a PPP slot.

3. A massive re-planogramming effort in chain supermarkets and perhaps a carton contract revision and the introduction of new hardware.

In short, we do not believe such an approach is feasible prior to the 4th quarter. We recommend the distribution strategy in Discussion 1 with a meet competition response to promotion and a Cambridge response in the chain supermarket trade class.

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Discussion 3

Assumed Scenario: Separate and distinct from a Philip Morris response to the Magna and Sterling initiative is our response to the Belair test and probable expansion of the brand at the subgeneric price point. Should Belair expand during the Marlboro Mediums launch, without a PM response until August, Alpine could lose an opportunity to fill the free standing menthol position in the subgeneric segment. There are numerous benefits to a quick Alpine expansion at a subgeneric price point:

1. Alpine's stronger share and distribution profile versus Belair assures it a menthol leadership position in the subgeneric segment.

2. Alpines net profitability will be higher as a subgeneric with lower DME.

3. It is likely to accelerate Salem's loss of volume and smoker base and/or cause RJR to spend at higher levels to defend that franchise.

4. The price reduction of Alpine may modestly reduce FSF labor devoted to P/V activities.

5. Alpine's position in C-stores makes it ideally suited for subgeneric proposition.

Logistics/Action Plan

We recommend an immediate price reduction on Alpine to current subgeneric levels under the following action plan:

1. Manufacturer List Price announcement reduction effective May 6.

2. Issuance of a credit memorandum for the difference between the old and the new list for 2 week inventory thereby enabling us to assume an immediate price reduction at the wholesale to retail level.

3. Alpine assumes BV position 1 in May, June and July with graphics announcing the new price.

4. All couponing at levels above $1.00 is halted May 6.

5. June 1st we provide 60% volume coverage @ $1.00 level with separate display.

6. Use of ROP in Alpine's key 52 markets on a weekly basis from May 6 through July announcing Alpine's new low price.

7. We develop creative for use in the 3rd and 4th quarter on behalf of Alpine intrusively referencing the Alpine/Salem

price differential. (We may be able to regulate the level of support RJR devotes to Magna/Sterling or at least make them assume an opportunity cost).

8. Alpine B1G1F's in May will be provided for any store committing to separate display.

Exact cost and volume assumptions are being developed and some adjustments to the plan outlined above may be necessary. Importantly however, the plan described above is actionable immediately. As we discussed last week, financials at varying levels of performance are as follows:

ALPINE SUB-GENERIC SHARE ASSUMPTIONS (ANNUALIZED)

	SHARE		
	0.61 (CURRENT)	1.0	1.2
VOLUME (UNITS IN MILLIONS)	3,078	5,079	6,095
FINANCIALS (IN MILLIONS):			
MARGINAL CONTRIBUTION	$40.5	$66.8	$80.1
DIRECT MARKETING *	($23.0)	($29.0)	($35.0)
NET CONTRIBUTION	$17.5	$37.8	$45.1

* ASSUMPTIONS:

- 25% OF VOLUME COUPONED AT $1.00
- STATIC RETAIL SUPPORT AT $14.3MM
- NO MEDIA

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